

ICPS newsletter

Budget Code will improve the quality of local budgets

The recently adopted Law "On the State Budget for the year 2001" inaugurates the reform of inter-budget relations in Ukraine: the document stipulates applying a formula for calculating transfers among budgets of different levels. This approach allows increasing the transparency of the flow of budget funds. However, the essential change in the role of local budgets will happen only upon adoption of the Budget Code, which is expected to take place in the nearest time. Tetiana Sytnyk, chief economist at the International Centre for Policy Studies, comments on the Budget Code implementation

Innovations in the draft Budget Code

The objective of the Budget Code is to regulate the budget process and inter-budget relations; this regulation should minimise opportunities for micromanaging public funds on a daily basis (so-called "manual" management) at all levels of the budget system. The draft Budget Code of Ukraine, passed by the Verkhovna Rada in the second reading on 13 July 2000, outlines current practice for developing, passing, and executing the State Budget; it also includes important innovations regarding inter-budget relations and developing local budgets. If the Budget Code is adopted, the most important changes will be related to the budget process at the level of local governments.

The larger part of the draft Budget Code is devoted to issues concerning local budgets.¹ In particular, the following blocks of norms can be identified:

- **regulation of procedures for developing, reviewing,**

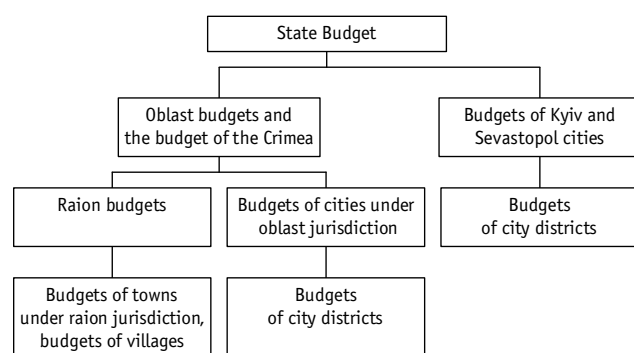
executing, and controlling local budgets. The draft assumes that managers of local budgets develop plans of their activities and submit budget requests to local financial bodies. The Ministry of Finance develops instructions regarding the content of budget requests and their evaluation in the local financial body;

- **creation of a new system for inter-budget relations.** Under the current system, oblast budgets are centres for revenue consolidation: oblast budgets include revenues from imposed taxes and levies, as well as transfers from the State Budget. Afterwards, oblast budgets distribute these revenues among the budgets of the cities and raions. The draft Budget Code, however, assumes that cities² and raions will also become centres for revenue consolidation. Budgets of these administrative units will consolidate revenues from imposed taxes and levies, as well as transfers from the State Budget; then the revenues will be distributed among district budgets in cities, as well as town and village budgets.

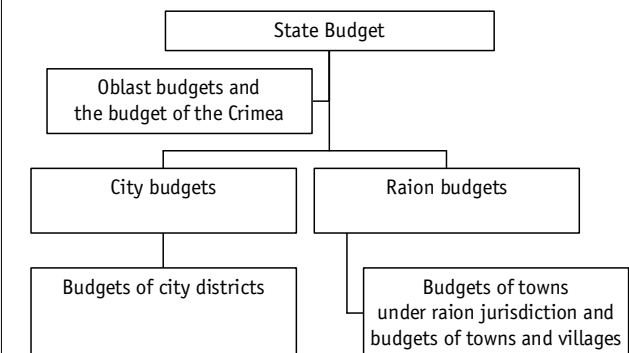
- **distribution of authority to execute expenditures and revenue distribution among budgets of different levels.** The draft includes a detailed list of original and delegated authorities for budgets of different levels. The document

¹ According to the definition given in the draft Budget Code, local budgets include those of the Autonomous Crimean Republic, oblast budgets, and budgets of local governments. The budgets of local governments include budgets of cities, towns, villages, and their conglomerations.

Budget system under current legislation



Budget system under the draft Budget Code



introduces the definition of local budgets' revenues basket—state taxes and levies whose revenues are assigned to the budgets of cities and raions for executing delegated state authorities. For the basket of revenues consolidated on the territory of cities and raions, the following distribution is assumed: 25% of these revenues will be channelled to oblast budgets, and no less than 25% to budgets of lower levels (budgets of towns under raion subordination, and budgets of towns, villages, and their conglomerations);

• **methodology for calculating the size of local budgets and inter-budget transfers.** The draft stipulates applying formulas which include the indicators of budget adequacy, tax capacity, and financial levelling. Firstly, upon the introduction of the new system for inter-budget relations, the need for the formula approach will increase, since the number of autonomous units of the budget process will increase. Secondly, applying the formulas will ensure stability in the size of local budgets and will enable medium-term planning.

Consequences of Budget Code implementation

We looked at the following criteria in our evaluation of the Budget Code.

1. Economic efficiency. We believe that thanks to the implementation of the Budget Code, the efficiency of budget resource usage will increase. Firstly, the Budget Code stipulates the autonomous and responsible role of local government bodies at the city level in the budget process. Secondly, planning procedures determined by the Code for local budgets will help to apply program budgeting at the local level. Thirdly, distribution of expenditures among budgets of different levels assumes decentralisation for delivery of those services from which benefit only the members of the local community (service delivery is approximated to consumers), and centralisation for delivery of those services from which benefit all Ukrainians (here, economies of scale apply³).

2. Financial equality. Local budget revenues will be mostly formed thanks to revenues and transfers from the State Budget (the own revenue base of local budgets remains weak in Ukraine). Correspondingly, on the expenditure side of local budgets, the outlays on execution of delegated state authorities will prevail. In this situation, applying the formula approach for determining the size of inter-budget transfers helps to level out local budgets in terms of finance and to ensure proper financing of state services.

² Here and further, the concept of "city" includes cities of oblast and republican subordination (in the Autonomous Crimean Republic), as well as Kyiv and Sevastopol.

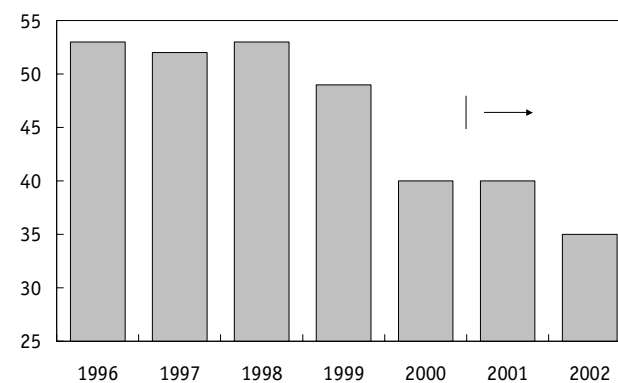
³ For instance, the Law on the 2001 State Budget assumes that outlays on sanitary-epidemiological services, civil defence, and law enforcement activities (excluding expenditures on professional fire prevention measures and the maintenance of specialised assembly and exploitation departments) will be fully transferred from local budgets to the state one.

3. Administrative efficiency. As a result of Budget Code implementation, the number of autonomous "budget units" will increase, but the procedures for developing and planning local budgets will improve concomitantly. Furthermore, the Budget Code includes a detailed description of control relations in the budget process. This will help to reduce the abuse of public funds.

4. Political responsibility. According to the draft Budget Code, procedures for control over the execution of local budgets are predominantly of administrative nature. At the same time, the Budget Code does not provide procedures for citizen participation in the process of control over the execution of local budgets. For instance, citizen participation entails open budget hearings and surveys regarding the quality of public services. As a result, local governments will not be appropriately responsible to the members of local communities; this will greatly hinder improvements in the quality of public service delivery.

The obstacle to reforming local budgets is the delayed implementation of administrative reform at the local level (mostly, the determination of a new role for oblast councils and oblast state administrations). For example, after administrative and territorial reforms in Poland, elected *wojewoda* is responsible for policymaking, while administration of the *wojewodztwo* is assigned to follow the principles of the national policy and law enforcement. Following this principle, oblast governments in Ukraine therefore should not distribute budget funds but engage instead in strategic planning and represent the common interests of local communities in the region. The reform of local budgets in Ukraine will be effective only if appropriate actions will be implemented for developing such a new role for oblast governments. ■

Local budget revenues, % of consolidated budget



Source: State Treasury

Forecast: International Centre for Policy Studies

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